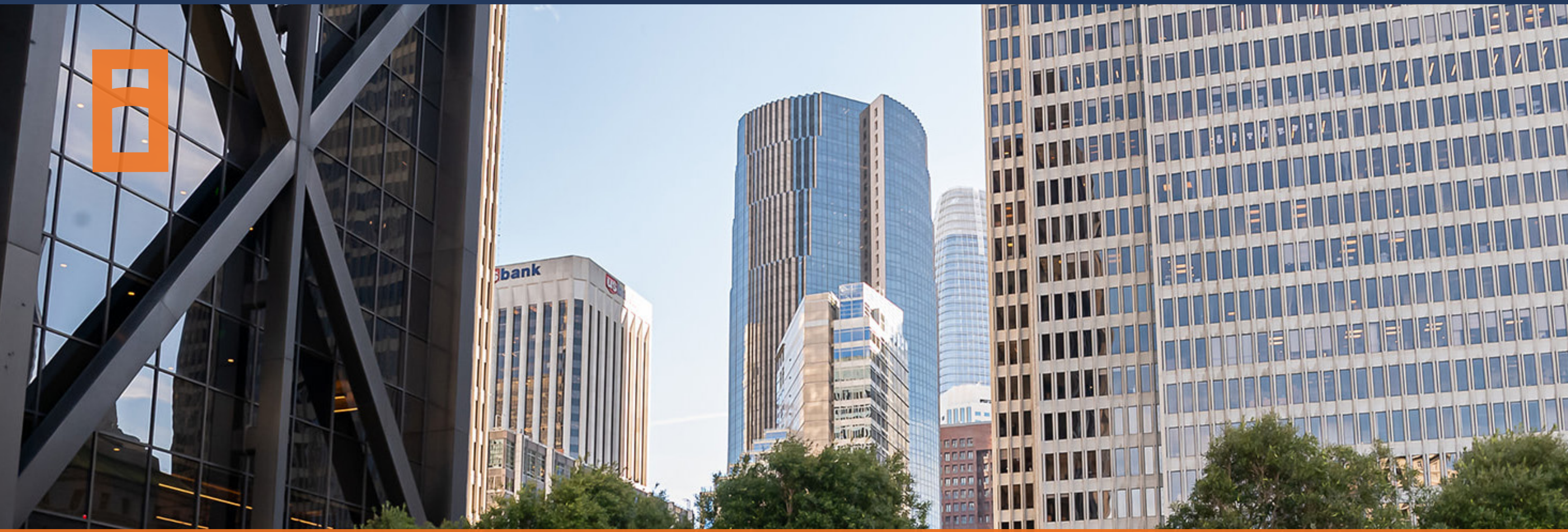


FINDING SCALE AND IMPACT IN MULTIFAMILY AFFORDABLE HOUSING

By Michael J. Lohmeier, Chief Investment Officer, IMPACT Community Capital

Among institutional investors, the first response to 'tax-exempt' or 'Muni-bond' opportunities may be a yawn or an eye roll. After all, investors commonly think of these as boring, low-yielding investments. But the potential of scalable opportunities, tax efficiency, competitive risk-adjusted returns, and tangible impact should prompt market participants to reassess their assumptions and consider these offerings.

Indeed, investors searching for scale and real-world impact would do well to look in this corner of the market ignored by many others. Often tax-exempt loans and bonds financing affordable multifamily housing offer a higher yield than other tax-exempt municipal bonds. Typically, the taxable equivalent yields on these issuances can be comparable to BBB rated debt, making them a viable option for investors seeking tax-efficient returns in their investment portfolio.

THERE IS A SHORTAGE OF APPROXIMATELY 7.3M AFFORDABLE AND AVAILABLE RENTAL HOMES

NEW OPPORTUNITIES GENERATED BY SHIFTING MARKET DYNAMICS

Growing opportunities in tax-exempt loans stem from the much-needed funding for developing or rehabilitating affordable multifamily apartments. The nation's affordable housing crisis has become more acute for various reasons, notably a lack of supply that has worsened amid rising inflation and the loss of low-cost rental homes.

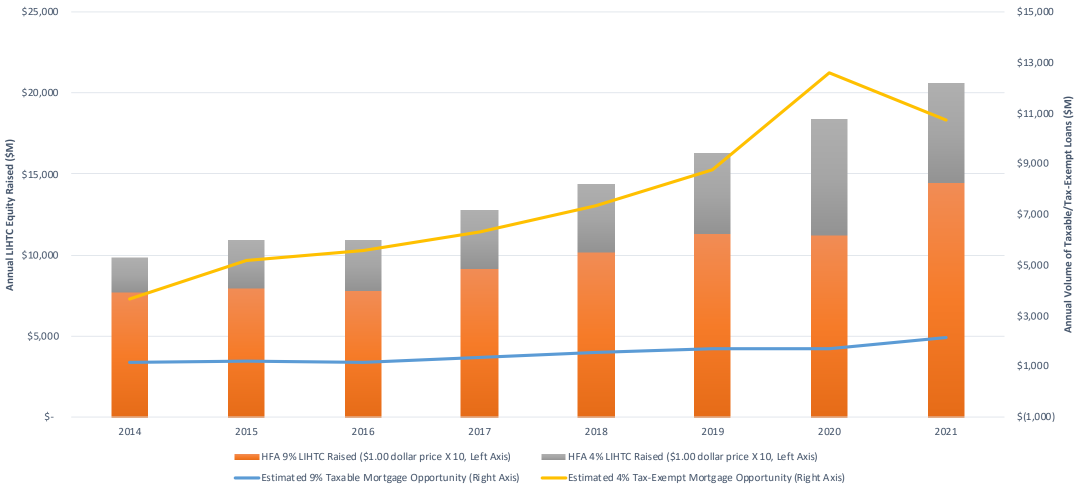
There is a shortage of approximately 7.3 million affordable and available rental homes, which means that for every 100 extremely low-income renter households, there are only 33 affordable and available homes, according to the National Low Income Housing Coalition's (NLIHC's) *GAP: A Shortage of Affordable Homes* report. The March 2023 report from NLIHC noted that the shortage of affordable and available rental homes for extremely low-income renters worsened during the pandemic.

Four percent LIHTCs are an underused resource that could be a key source of financing for housing at a time of limited budget capacity for state and local governments...

Tax-exempt loans and bonds issued by state and local agencies, many of which are Housing Finance Agencies ("HFAs"), play an essential role in addressing the shortage of affordable housing. Limited governmental resources such as a 9% Low Income Housing Tax Credit, or LIHTC, and other subsidy dollars create an opportunity to use tax-exempt Private Activity Bond Volume Cap for housing. Using tax-exempt Private Activity Bond Volume Cap allows for an additional allocation of 4% LIHTCs at the state or local level. Four percent LIHTCs are an underused resource that could be a key source of financing for housing at a time of limited budget capacity for state and local governments, elevated concerns about the federal budget deficit, and increased uncertainty about the nation's overall economic outlook.

As demand for affordable housing continues to rise, states have been increasing Private Activity Bond Volume allocations for multifamily affordable rental housing. As shown in **Figure 1**, the LIHTC tax-exempt market (grey bars) and IMPACT's estimates of tax-exempt loan opportunities have increased significantly since 2016 (yellow line).

Figure 1[1]: LIHTC Annual Equity Raised and Taxable/Tax-Exempt Loan Opportunities 2016-2021



For taxable investors, 4% LIHTC issuances are an opportunity to **drive impact through a tax-efficient investments.**

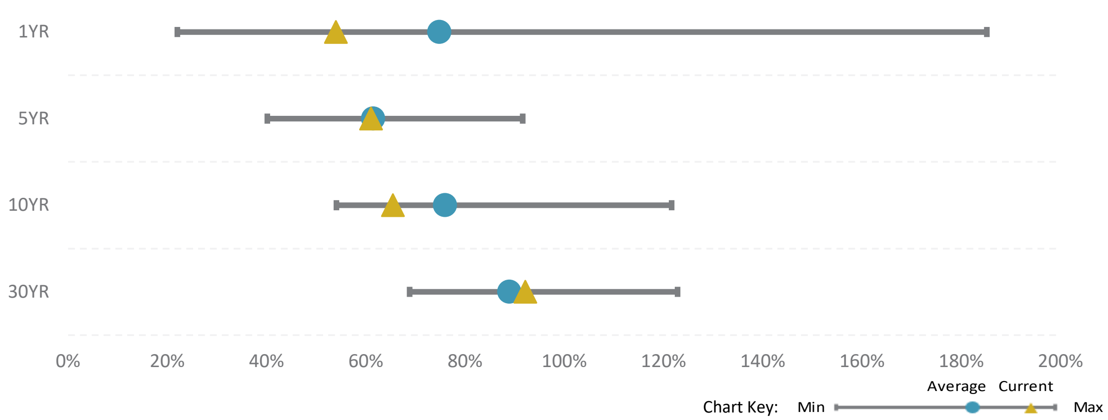
IMPACT INVESTING WITH TAX-EFFICIENCY

For taxable investors, 4% LIHTC issuances are an opportunity to drive impact through a tax-efficient investment. Affordable housing bonds are typically exempt from federal income tax and may also be exempt from state and local income taxes. These returns may be higher than taxable fixed-income alternatives, as measured by the taxable equivalent yield. These tax exemptions make them an alternative option for investors looking for tax-advantaged returns.

However, for institutional investors- regardless of tax status- the benefits of tax-exempt issuances that fund affordable multifamily housing are evident when considering the ratio between tax-exempt and taxable yields. As shown in **Figure 2**, the historical average of 10-year tax-exempt municipal bonds to taxable bonds or Treasuries is ~80%, which coincides with the corporate tax rate of 20% on taxable income.

The opportunity to arbitrage this market arises when repackaging tax-exempt affordable mortgage loans into Fannie Mae or Freddie Mac securities. The market currently prices affordable multifamily loans at a ratio of 90% to taxable bonds, which drives a return premium when market conditions revert to the long-term average ratio of about 80%. Additionally, packaging tax-exempt loans backed by affordable housing mortgages through securitization creates the potential for additional return as retail investors place an even greater value on the tax-exempt income from these loans. The ratio of 5-year municipal bond yields to U.S. Treasury yields is ~60%, reflecting the 40% tax rate for many individual investors.

Figure 2[2]: AAA Municipal Bond Yields as % of Treasury – Two Year History



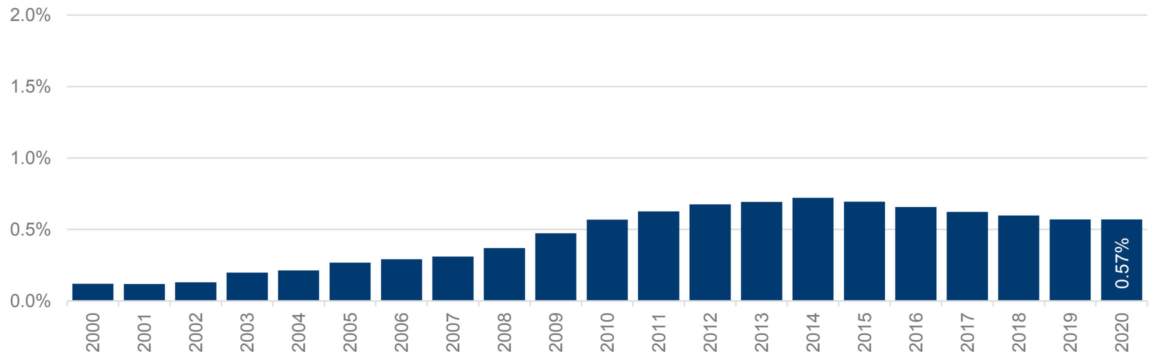
[1] Source: National Council of State Housing Agencies HFA Factbook 2021. The estimated taxable and tax-exempt mortgage opportunity shown is based on the average debt allocation within the total capital stack. Debt allocation is estimated using an average ratio of 1.75 debt to equity. The average debt to equity ratio is based on IMPACT investments since strategy inception in 2003.

[2] Source: Piper Sandler, ICE

STABLE OPERATING PERFORMANCE AND LOW FORECLOSURE RATES SUPPORT REDUCED INVESTMENT RISK

The high demand for affordable housing discussed earlier drives robust operating performance in tax-exempt affordable housing loans across market cycles. Consequently, these issuances have historically had a low default rate, similar to high-grade corporate debt issuances. Notably, the cumulative foreclosure rate for LIHTC properties, or housing restricted as affordable through federal tax credits, is lower than multifamily debt issued by FDIC-insured institutions, as shown in **Figure 3**[3]:

Figure 3: Cumulative Rate (by property count)



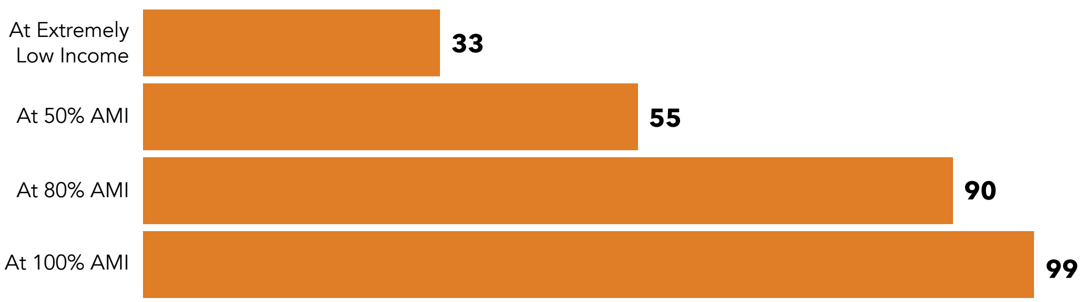
Beyond their scalability and the fact that these loans can generate meaningful real-world impact, historically debt backing these issuances has a lower default rate than other real estate classes, providing a low-risk addition to an investor's overall investment portfolio. Data shows that tax-exempt municipal debt funding affordable multifamily housing may be less risky than other asset classes such as commercial mortgage-backed securities, or CMBS, pooling multifamily mortgages and high-grade corporate debt.

Meanwhile, the current inversion of the Treasury yield curve amid increases in the Fed Funds Rate may portend an economic downturn. Tax-exempt affordable multifamily offerings may be an appropriate option for institutional investors, such as insurers and pensions, who want to lock in high yields ahead of any downturn that causes the Federal Reserve to slow or reverse its tightening of credit.

STRONG POSITIVE SOCIAL IMPACT

In addition to tax-exempt loans being appealing financial investments, these issuances can potentially drive meaningful, real-world impact for the nation's communities. Affordable housing bonds provide much-needed housing for low- and moderate-income families, individuals, and seniors. Housing funded by tax-exempt bonds must set aside at least 40 percent of apartments for families with incomes of 60 percent of area median income (AMI) or less or 20 percent for families with incomes of 50 percent of AMI or less. At these income levels, there is still a dramatic shortage of affordable housing, as shown in **Figure 4**[4]:

Figure 4: Affordable and Available Renter Homes per 100 Renter Households, 2021



Source: 2021 ACS PUMS
AMI = Area Median Income

[3] Source: Affordable Housing Credit Study, CohnReznick, Nov. 2021. Future conditions could vary and result in materially higher foreclosure rates.

[4] Source: GAP Report, NLIHC 2023

Amid the backdrop of the current housing affordability crisis, the new units financed by tax-exempt loans can add substantial new housing inventory at a time when it is sorely needed. In 2021, for example, housing finance agencies turned to the tax-exempt market to finance nearly 63,000 affordable apartments, many of them for underserved households.[5]

For individual residents and families, affordable housing has a ripple effect of benefits. When the new housing is well-planned, it can offer residents easy access to transportation, jobs, and needed services. When the new housing is affordable, residents are not forced to choose between making rent payments and paying for other essentials, like healthcare and childcare. Access to affordable housing can also support family stability and bolster community resilience. In these ways, it is a fundamental building block toward a more equitable and inclusive society.

Given the critical shortage of affordable housing and the profound real-world benefit that new units create, such tax-exempt loans are a practical investment solution for institutional investors seeking to impact on the lives of families and individuals positively.

In 2021, for example, housing finance agencies turned to the tax-exempt market to finance nearl **63,000 affordable apartments,** many of them for underserved households.

THE CASE FOR TAX-EXEMPT AFFORDABLE HOUSING DEBT

Multifamily tax-exempt loans and structured bond transactions offer investors tax-exempt income that can be an attractive alternative to other fixed-income securities. When considering certain tax benefits, they can provide higher returns than expected among investors less familiar with this market.

When there is more significant uncertainty about the larger economy and how higher rates may impact various fixed-income asset classes, tax exempts offer another benefit: loans backing these issuances have low default rates compared to other multifamily debt resold into CMBS.

Institutional investors seeking scale and impact opportunities will find both in this little-known corner of municipal finance that has come to play an important role in bolstering the supply of affordable multifamily housing for low-income renter households.

[5] Source: NCSHA, https://www.ncsha.org/advocacy-issues/housing-bonds/

Multifamily tax-exempt loans and structured bond transactions offer investors tax-exempt income that can be an attractive alternative to other fixed-income securities.